Original Research Article

The Influence of Profitability and Liquidity on Firm Value (Case Study on a Non-Financial Company Indexed ESG Quality 45 IDX-Kehati on the Indonesia Stock Exchange 2017-2020)

ABSTRACT

Aims: This study aims to determine the influence of Profitability and Liquidity on Firm Value, as previous research results were inconclusive, inconsistent, and sometimes contradictory.

Study Design: This research is correlational quantitative research using multiple linear regression.

Methodology: This study uses 35 non-financial companies indexed ESG Quality 45 IDX-Kehati listed on the Indonesia Stock Exchange for the period 2017-2020 as recently public's interest in investing in shares of companies that implement ESG is getting higher. Cross-sectional data of financial ratios are used and analyzed by SPSS version 25.

Results: The results of this study provide empirical evidence that profitability, as measured by return on assets (ROA), has a positive and significant effect on firm value, measured by Price to Book Value (PBV). Unexpectedly, the Liquidity, measured by the current ratio (CR), does not affect firm value.

Conclusions: Profitability is the main fundamental factor in increasing firm value. Thus, managers must generate net profit by maximizing the productivity of all company's assets. The higher the profitability, the greater the company's ability to distribute part of the company's wealth to shareholders in dividends and retain some earnings to be reinvested to avoid the risks of using excessive debt. High profitability earned ethically in the long term reflects the prospects for the sustainability and resilience of the company, and in turn, generates positive sentiment from investors represented by the increase in stock prices and the firm's value. However, as the coefficient of determination (R^2) in this study is of 28%, further research is advised to add other variables that are not examined to strengthen and confirm the results of this study.

Keywords: Firm Value; Profitability; Liquidity; ESG Implementation

1. INTRODUCTION

Firm value is a condition of public trust and expectation of future profitability and risk [6,11]. All information owned by business people regarding the company's future expectations is summarized in the stock market price. Stock prices are often used as an indicator of the success or failure of a public company. The higher the increase in stock market prices, the higher the value of the company, and vice versa [36,17].

According to the President Director of the CSA Institute, when a company does not generate profits or growth, its share price drops because it is less attractive to investors [35]. For example, during the COVID-19 pandemic, some companies experienced a decline in stock prices due to losses and lack of liquidity. Boby [5] revealed that stock prices in 2020, after the COVID-19 pandemic, compared to 2015, before the COVID-19 pandemic, 17 out of 30 companies (57%) indexed IDX-30 on the Indonesia Stock Exchange, fell between -4 % up to -84%.

Profitability information is an important indicator of company performance [18.10]. High profitability indicates good prospects so that investors will react positively as indicated by an increase in stock prices as a representation of company value [10,31]. Another factor that affects firm value is liquidity risk. Adequate liquidity ensures smooth operations and reduces the risk of company bankruptcy [36]. Therefore, liquidity provides a positive perception for investors and can increase the value of the company [2,15]. However, with the extraordinary event of the COVID-19 pandemic which has resulted in a global economic downturn, it can also become a benchmark for the company's resilience and sustainability.

Dang et al. [8] state that firm value attracts much attention from corporate executives and researchers. However, the results of previous studies show many differences, are inconsistent, and sometimes contradictory due to different techniques and measurements, so up to now, it is inconclusive what factors affect firm value. For example, Clara [7] using data from 11 infrastructure, utility, and transportation sector companies listed on the IDX in 2015-2019 found that profitability (ROA) had a positive effect on firm value (PBV), while liquidity (CR) had a negative effect on firm value (PBV). . Shofi and Irvan [32] using data from 9 companies in the Food and Beverage sub-sector in 2015-2019 and Fransisca [12] using data from 60 IDX manufacturing companies in 2016-2018 found that profitability (ROA) has a positive effect on firm value (PBV), but liquidity (CR) has no effect on firm value (PBV). Ida Ayu and Ida Bagus [20] using the Construction and Building sub-sector data for 2013-2017 show that profitability (ROA) has a positive effect on firm value (PBV), but liquidity (CR) has no effect on the firm value (PBV). The results of another study, Sondakh [34] using data from 12 companies in the financial services sector listed on the IDX in 2015-2018, found that profitability (ROA) had no effect on firm value (PBV), but liquidity (CR) had a positive effect on firm value (PBV).

IDX President stated that global challenges encourage various parties to be increasingly aware of the importance of implementing environmental, social, and governance (ESG) aspects in their business activities so that the post-pandemic economic recovery is sustainable [26]. The BNP Paribas survey shows that the COVID-19 pandemic has increased investor interest in investing in companies that implement ESG aspects by 20%, while 79% of respondents agree that companies that care about ESG will have a positive impact on long-term investment returns [3]. The Head of the Investment Research Division at Infovesta Utama Indonesia stated that issuers that implement ESG investments provide better guarantees for the company's sustainability prospects [28].

To make it easier for investors to invest in shares in companies that implement ESG, on December 15, 2021, the Indonesia Stock Exchange (IDX) provided information on 45 companies indexed by ESG Quality 45 IDX Kehati, namely companies whose business activities are not tobacco, weapons, pornography, alcohol, coal mining. ,

nuclear, gambling, pesticides, and genetic engineering, which have good financial performance and stock trading liquidity, also apply good ESG aspects. The environmental aspect is demonstrated by having sustainable product innovations through the use of natural resource energy, reducing carbon, and waste management. The social aspect is shown in training, development, and policies that protect the health and safety of human resources, protect consumer rights and product safety, and reduce environmental social impacts. Aspects of governance are indicated by disclosure of information, protection of shareholder rights, the competence of the roles of the board of commissioners and directors, implementing business ethics, and sustainability management. The grouping of 45 companies into ESG Quality 45 IDX-Kehati aims to encourage all companies to implement ESG aspects in their business processes in order to improve sustainable financial performance [4]. Head of West Java IDX Representative, Reza Sadat Shahmeini, referring to March 2022 data, stated that the stock index of 45 ESG Quality companies increased 5.11%. This indicates that ESG-indexed companies are able to provide higher returns than other public companies [19].

Based on the above phenomenon, the authors are interested in conducting research on the topic of the Influence of Profitability and Liquidity on Firm Value (Case Study on Non-Financial Companies Indexed ESG Quality 45 IDX-Kehati period 2017-2020). Financial sector companies were excluded from the study because they had their own regulations, such as measuring liquidity with the loan to deposit ratio (LDR), while the most commonly used liquidity measurement was the current ratio (CR) [1,27].

The formulation of the research problem is how much influence profitability has on firm value and how much liquidity affects firm value.

2. LITERATURE REVIEW

2.1 Firm Value

Firm value is the current and potential benefits generated by the company during the company's operations [8]. The firm's value represents the public's trust in the company's business [11]. According to Wahlen et al. [36], the firm's value is related to the profitability and risk of the company in the future. According to Brigham and Houston [6], to maximize the value of the firm, managers have an ethical responsibility to comply with the restrictions of not polluting the environment, not engaging in unfair labor practices, and not violating antitrust laws, and others. Based on the definitions above, it can be said that firm value is the company's ability to ethically maximize profitability and guarantee cash flow thereby increasing investor confidence as indicated by an increase in stock prices.

According to Wahlen et al. [36], investors and market traders usually determine the firm value using the stock market value ratio associated with accounting numbers, namely the Market to Book (M/B) ratio or Price to Book Value (PBV), formulated as follows:

$$\text{Price to Book Value (PBV)} = \frac{\text{Market Price per Share}}{}$$

The higher the PBV, the higher the firm value. Previous studies that measure firm value using Price to Book Value (PBV) were such [2, 7, 12, 15, 20, 30, and 32],

2.2 Profitability

Profitability is the company's ability to use all of its assets to generate revenue that exceeds its costs [10]. According to Wahlen et al. [36] profitability is a measure of management performance and future risk that is often used as the basis for investment decisions. Investment analysts use financial statements to analyze past and current profitability as an indicator or signal of future revenue growth and profitability [36].

According to Brigham and Houston [6], one of the financial ratios to analyze and measure profitability is the rate of return on assets (ROA) which informs the company's ability to generate net profits from all company assets, formulated as follows:

$$\text{Return on Assets (ROA)} = \frac{\text{Net Income}}{\text{Total Assets}} \times 100\%$$

Yesidora [37] believes that ROA is a measure of the company's efficiency and effectiveness in managing assets as well as debt, not ROE because ROE is profit performance after deducting debt. Previous researchers who used ROA to measure profitability were [1,7,12,16, 20, 22, 25, 32].

2.3 Liquidity

Liquidity is the company's ability to meet its short-term obligations as they mature [13]. According to O'Regan [27] liquidity is related to working capital which must be managed carefully because liquidity is directly related to the money-generating capacity that is the lifeblood of any type of business. Wahlen et al. [36] state that liquidity is the company's ability to continue to operate and avoid bankruptcy. According to Brigham and Houston [6], companies that experiencing liquidity difficulties usually pay their debts more slowly and borrow more from banks, both of which will increase liquidity risk. According to O'Regan [27] the most commonly used ratio to assess company liquidity is the current ratio, formulated as follows:

$$\text{Current Ratio (CR)} = \frac{\text{Current Assets}}{\text{Current Liabilities}} \times 100\%$$

According to Brigham and Houston [6], companies must have adequate current ratios. If liquidity is too high, it indicates the company has too much cash and unproductive inventories and receivables. Conversely, if it is too low, it means that

the company faces liquidity risk. Previous researchers who assessed company liquidity using the current ratio (CR) included [2, 7, 12, 22, 25, 32, 33, 38].

2.4 Conceptual Framework

2.4.1 Effect of Profitability on Firm Value

High profitability allows the company to distribute its wealth in the form of dividends to shareholders and invest retained earnings in the company. High profitability indicates the company's prospects so that investors will react positively which has an impact on increasing stock prices and company value [31]. This is supported by previous research by [7,12, 20, 32] which found that profitability (ROA) had a positive effect on firm value (PBV).

2.4.2 Effect of Liquidity on Firm Value

According to Fridson and Alvarez [13], liquidity is an important factor for credit analysts and investors because cash flows from operations are more difficult to manipulate by companies. Liquidity plays a role in the success of the company and can convince investors regarding the continuity of the company's operations, including the availability of dividends [2]. Liquid companies tend to use internal sources of funds rather than the debt which will reduce liquidity [21]. Thus, adequate liquidity can lead to a positive perception of the company for investors, thereby increasing the value of the company [15]. This is supported by previous research by Darmawan et al. [9] and [24] who found that liquidity (CR) had an effect on firm value (PBV).

Figure 1 Conceptual Framework

2.4.3 Hypothesis

Based on the description above, the hypothesis in this study is as follows:

H1: Profitability has an effect on Firm Value
H2: Liquidity has an effect on firm value.

3. METHODOLOGY

3.1 Methods, Samples, and Data Analysis

This research method is quantitative using a purposively selected sample of 35 non-financial companies listed on the Indonesia Stock Exchange indexed ESG-45 Quality

IDX-Kehati in 2021. Financial sector companies were excluded from the sample because they have their own regulations and characteristics [1], for example, liquidity is measured by the Loan to Deposit Ratio (LDR), while liquidity measurement generally uses the current ratio [27].

The research data is cross-sectional data, that is the average ratio of PBV, ROA, and CR based on financial statements for 2017-2020. Data analysis using SPSS v.25 based on a multiple linear regression model. The multiple linear regression equation in this study is as follows: $PBV = b_0 + b_1ROA + b_2CR + e_i$

Where PBV is a proxy for Firm Value, b_0 is a constant, b_1 is the correlation coefficient of X_1, X_1 is ROA as a proxy of Profitability, b_2 is the correlation coefficient of X_2, and X_2 is CR as a proxy for liquidity, and e_i is the standard error.

4. RESULTS

4.1 Descriptive Statistical

Based on sample data of 35 companies, the output of SPSS Descriptive Statistics is as follows:

Table 1 Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	35	-3.390	38.56	7.100	7.635
CR	35	22.28	621.46	227.49	159.510
PBV	35	2.690	4501.25	190.20	757.530
Valid N (listwise)	35				

The results of the descriptive test showed that the average profitability (ROA) was 7.10% with the lowest ROA at -3.39% and the highest at 38.56%. Average Liquidity (CR) is 227% with the lowest CR being 22.28% and the highest being 621.46%. Meanwhile, the average PBV ratio is the stock market price of 190.20 times the book value of shares, with the lowest PBV of 2.69 times and the highest of 4.501 times. Overall, the trend of ROA, CR, and PBV decreased slightly from 2017 to 2020. This is most likely due to the economic downturn due to the COVID-19 outbreak in 2020.

4.1 Testing Hypotheses

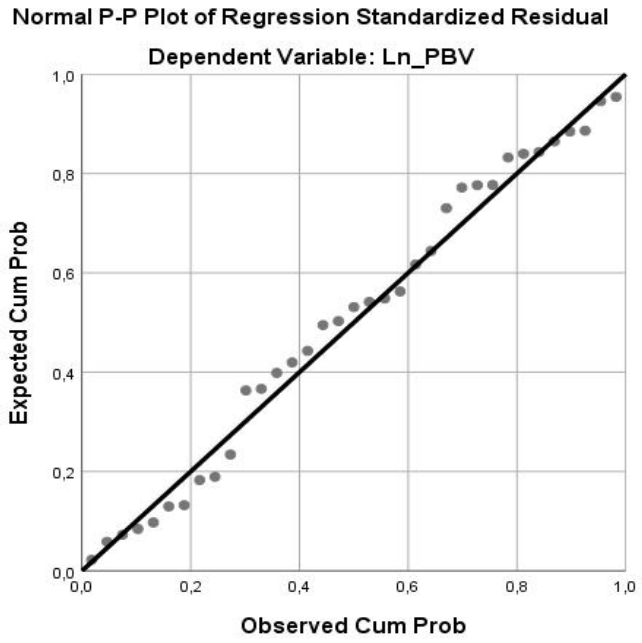
4.1.1 Classical Assumption Test

The classical assumption test is a statistical requirement in regression analysis in order to provide the Best Linear Unbiased Estimate (BLUE) estimation results. The classical assumption test includes normality, multicollinearity, and heteroscedasticity tests, while the autocorrelation test does not need to be carried out because the data in this study are cross-sectional data [14].

Initially, the results of the normality test showed that the regression residual value was not normally distributed. To treat it, the data is transformed into natural semi-logarithms (semi-logs) [14]. The data that is transformed in this research is the dependent variable (PBV). After the transformation, the SPSS output shows that the residual data in the regression model are normally distributed (Figure 2). Likewise,

the results of the Shapiro-Wilk test show a residual value of Sig 0.461>0.05, which means that the data is normally distributed and the assumption of normality is met.

Figure 2.
Normality Test Result after Semi-Log Data Transformation (Ln_PBV)



The multicollinearity test results show the Variance Inflation Factor (VIF) < 10 and tolerance values > 0.10, which can be concluded that there is no multicollinearity. The results of the heteroscedasticity test are met because the residual values in the scatterplot graph do not spread above and below the 0 (zero) point and do not form a certain pattern [23]. Also, the result of the Glejser test showed that the two independent variables ROA and CR have values of sig > 0.05, which means that there was no heteroscedasticity in the regression model in this study. As the requirements of normality, multicollinearity, and heteroscedasticity are met, the regression results to test research hypotheses are unbiased, accurate, and consistent [24].

4.1.2 Goodness of Fit (F-Test)

The F test was performed to test the joint effect of the independent variables on the dependent variable. In this study, the F test is to examine the joint effect of the predictor variables Profitability (ROA) and Liquidity (CR) on a dependent variable Firm Value (PBV). The results are as follows:

Table 2 F-Test Results

ANOVA[a]						
Model		**Sum of Squares**	**df**	**Mean Square**	**F**	**Sig.**
1	Regression	25,749	2	12,874	6,219	,005[b]
	Residual	66,249	32	2,070		
	Total	91,998	34			

a. Dependent Variable: Ln_PBV
b. Predictors: (Constant), CR, ROA

Table 2 above shows the regression value of Sig. 0.005 < 0.05 which means that, with a 95% confidence level or significance (α) < 0.05, the independent variables simultaneously affect the dependent variable significantly. Thus the regression model meets the requirements of the goodness of fit to test the research hypothesis (t-test) [14].

4.1.3 Hypothesis Test Results (t-test)

The t-test is to determine the effect of each independent variable Profitability (ROA) and Liquidity (CR) on Firm Value (PBV). The results of the t-test is as follows:

Table 3 t-Test Results

Coefficients[a]						
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	2,623	,464		5,657	,000
	ROA	,115	,033	,533	3,515	,001
	CR	-,038	,156	-,037	-,243	,809

a. Dependent Variable: Ln_PBV

In Table 3 above, the results of hypothesis testing (H_1) show that the ROA value is Sig 0.001 <0.05, and using t-Table, the t-count is 3.515 > t-table 2.037, which those two tests conclude that H0 is rejected and H_1 is accepted. Thus, the results of the hypothesis testing of H_1 provide empirical evidence that Profitability (ROA) has a positive effect on Firm Value (PBV). As the coefficient value (B) of ROA is +0.115, means that every a hundred percent increase in Profitability (ROA) will increase the stock price or Firm Value (PBV) by 11.5%. The results of hypothesis testing (H2) show CR Sig 0.809 > 0.05, and using the T-table shows t-count -0,243 < t-table -2.037, it is concluded that H0 is accepted and H_2 is rejected. Thus, the results of hypothesis testing (H_2) provide empirical evidence that Liquidity (CR) has no significant effect on Firm Value (PBV). Based on the results of this study, the multiple linear regression equation models is as follows:

$$\textbf{Firm Value (PBV) = 2.623 + 0.115 ROA – 0.038 CR + e}$$

This regression model shows that the firm value (PBV) without the influence of any factors is constant at 2.623 or 2.6% and a 100% increase in profitability (ROA) will increase the firm value (PBV) by 11.5%. However, Liquidity (CR) has no effect on Company Value (PBV), so any change in CR value does not change the PBV value.

4.1.4 Coefficient of Determination (R^2)

Table 4 shows that the coefficient of determination (R^2) is 28%, which means that the Profitability (ROA) and Liquidity (CR) variables can explain variations in the Firm Value (PBV) by 28%, while 72% is explained by other variables not examined.

Table 4 Coefficient of Determination (R^2)

Model Summary[b]				
Model	r	R Square	Adjusted R Square	Std. Error of the Estimate
1	,529[a]	,280	,235	1,43885

a. Predictors: (Constant), CR, ROA
b. Dependent Variable: Ln_PBV

4.2 Discussion

The results of this study provide empirical evidence that Firm Value (PBV) is influenced by Profitability (ROA), but unexpectedly, Liquidity (CR) has no significant effect. The results of this study indicate that profitability is the main business fundamental factor and is very important to increasing firm value. Profitability, as measured by ROA, indicates that managers must generate net profit as optimally as possible by maximizing the productivity of all assets used and owned by the company. The higher the ROA, the greater the company's ability to distribute part of the company's wealth to shareholders in the form of dividends and retain some of the profits to be reinvested so that the company's asset financing does not depend on debt which can risk a decline in company wealth. The findings of this study are in line with the theory that high and ethical profitability in the long term reflects the prospects for the sustainability and resilience of the company so as to generate positive sentiment from investors which is represented by an increase in stock market prices, thereby increasing the Company Value [6, 31].

The findings of this study support the results of previous studies by [7, 12, 20, 32]. With the research sample of ESG Quality indexed companies from IDX-Kehati, this finding also supports the phenomenon of increasing public interest in investing in companies that have implemented ESG, that profitability is an important factor that increases stock prices, and firm value.

Unexpectedly, the research findings show that Liquidity (CR) has no significant effect on Firm Value. Perhaps this is because investors tend to be more interested in profitability than liquidity which is directly related to daily business operations, not long-term prospects. However, the results of this study support the results of previous studies by [12, 20, 29, 32], who found that liquidity (CR) had no effect on firm value (PBV).

5. CONCLUSION

The results of this study provide empirical evidence that profitability has a positive effect on firm value, while liquidity has no significant effect on firm value. Thus, the results of the study suggest that the main task of companies' managers is generating net profit as optimally as possible by maximizing the productivity of all company's assets. The higher the profitability, the greater the company's ability to distribute dividends, as a part of the company's wealth, to shareholders and able to retain some earnings to be reinvested in assets so avoid the use of excessive debts that is risky in declining the shareholders' wealth. However, because the coefficient of determination (R^2) in the research results is only 28%, further researchers are advised to add other variables that are not examined and confirm the results of this study.

COMPETING INTERESTS DISCLAIMER:

Authors have declared that they have no known competing financial interests OR non-financial interests OR personal relationships that could have appeared to influence the work reported in this paper.

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